Malaysian Trustees Bhd v Transmile Group Bhd & Ors

COURT OF APPEAL (PUTRAJAYA) — CIVIL APPEAL NO W-02(IM)(NCC)-3695 OF 2010
RAMLY ALI, JEFFRY TAN AND ZAHARAH IBRAHIM JJCA
21 NOVEMBER 2011

Companies and Corporations — Priorities — Right of priority (pari passu rule) — Priority of appellant as creditor — Preliminary issue — Appellant as trustee of medium terms notes ('MTN') — MTN constituted by trust deed — Clause 10.1(cc) — Whether appellant ranked in priority to other groups of unsecured creditors — Whether amount owing by second respondent to appellant had priority over syndicated term loan and convertible bonds — Whether equitable priority rule applied at expense of an express statutory provision — Whether restrictive effect of cl 10.1(cc) could be extended to other creditors not parties to trust deed — Companies Act 1965 s 292(2)

The appellant was appealing against the decision of the High Court regarding a preliminary issue on the priority of the appellant as creditor of the second respondent ('TAS') where the learned judge answered the preliminary issue in the negative to the effect that the appellant did not have any better right of priority to other unsecured creditors and that the appellant's debts must rank pari passu with the other unsecured scheme creditors. In this case, the appellant was the trustee for the holders of medium terms notes ('MTN') issued by TAS in 2003. As a trustee, the appellant at all material times was an unsecured creditor of TAS. The MTN were constituted by a trust deed executed between TAS and the appellant. By cl 10.1(cc) of the trust deed, TAS covenanted with the appellant that TAS would 'ensure that all or any advances by any of the shareholders, its directors and/or related corporations or any permitted intercompany loan and advances made after the date of the trust deed are subordinated to TAS's liabilities under the CP/MTN Programme'. The third to 14th respondents are bankers, where by a facility agreement, granted an unsecured syndicated term loan to Transmile Air (SPV) Ltd, a wholly owned subsidiary of the first respondent ('TGB'). By an assignment dated 7 September 2010, Transmile Air assigned the debt owing by TAS to the individual bankers ('the third to 14th respondents'). Meanwhile the 15th respondent was a wholly-owned subsidiary of TGB ('the first respondent'). The 15th respondent issued convertible bonds in 2005. The bonds were constituted by a trust deed dated 17 May 2005. TGB guaranteed the convertible bonds. The substantive action in this proceeding was brought by TGB and TAS under s 176 of the Companies Act 1965 with respect to a proposal to effect a scheme of arrangement between TGB and TAS and a group of creditors ('TAS scheme creditors'). The TAS scheme creditors comprised three groups of creditors; it

was proposed by TGB and TAS that these three groups of creditors, be all treated as members of a single class of unsecured creditors for the purpose of voting at the requisite court-convened scheme-creditors meeting to be held in due course before the proposed scheme was implemented. This classification of a single class of unsecured creditors was however opposed by the appellant who maintained that their rights as the trustee to the MTN holders, although admittedly as an unsecured creditor of TAS, was nevertheless distinct and ranked in priority to the other two groups of unsecured creditors, in so far as satisfaction from available assets were concerned. The parties, by an agreement amongst themselves, formulated the following preliminary issue: 'whether the amount owing by TAS to the appellant under the MTN has priority over the amount originally owing by TAS to Transmile Air (SPV) Ltd under the syndicated term loan, that has since been assigned by Transmile Air to the third to 14th respondents (in the present appeal); and the amount owing by TAS to the 15th respondent (in the present appeal) under the convertible bonds'. The learned judge answered the preliminary issue in the negative ie the unsecured debt arising from the MTN loan to TAS did not have any better right of priority to the other unsecured debts of the syndicated term loan and the convertible bond; and therefore the MTN debt must rank pari passu with the other scheme creditors. The learned judge also held that cl 10.1(cc) in the MTN trust deed was not a 'subordination' clause and that there was no express contract between individual lenders of the syndicated term loan and the convertible bond holders (or any of them) with either TAS or even TGB agreeing to relegate their rights as creditors to ranks lower than the other unsecured creditors of TAS.

Held, dismissing the appeal with costs:

(1) The syndicated term loan lenders and the convertible bond holders, either directly or through their respective special purpose vehicles (Transmile Air Ltd and TGB (SPV) Ltd), were not contractually bound to the obligations under cl 10.1(cc) of the MTN trust deed. There was no evidence to support the contention that the loan and bond agreements made in 2005 for the benefit of TAS were entered on the footing that the debts arising thereby were 'subordinate' to repayment by TAS of the MTN debts. The two special purpose vehicles were not parties to the MTN trust deed, which was entered into on 8 August 2003 between TAS and the appellant. Clause 10.1(cc) in the MTD trust deed came into force in 2003 while the said special purpose vehicles which were incorporated in 2005, were not even in existence at that time and therefore could not operate on them (see para 19).

(2) The pari passu rule in Malaysia is a statutory rule. It confers express right to the creditors when the company is under liquidation. It cannot be excluded, unless expressly agreed by the creditor itself. Its agreement to subordinate or to waive the right only binds itself. A creditor and debtor

cannot agree to subordinate the debts of another creditor not a party to the agreement. The correct position of law is that the pari passu rule will apply to TAS debts and all its unsecured creditors, unless the lenders to the syndicated term loan and the convertible bond holders specifically contracted away their right to rank pari passu or are estopped from claiming a pari passu ranking. The unsecured debts arising from the MTN loan to TAS did not have any better right or priority to the other unsecured debt of the syndicated term loan as well as the convertible bonds (see para 27).

(3) Equitable priority rule cannot be applied at the expense of an express statutory provision of s 292(2) of the Companies Act 1965 ('Act'). To allow the equitable priority rule in the present case will obviously be contrary to the spirit of the express provisions under s 292(2) of the Act (see para 32).

(4) No agreement ever existed between the debtor (TAS) and the creditors (in respect of the syndicated term loan as well as the convertible bonds), with regard to the alleged subordination of debt. The facility agreement dated 16 May 2005 (in the case of the syndicated term loan) and the trust deed dated 17 May 2005 (in the case of the convertible bonds) provide no such express provisions. It was also obvious that cl 10.1(cc) only spelt out TAS's obligation to ensure that inter-company loans or advances were subordinated to TAS's liabilities under the MTN programme. Clause 10.1(cc) was therefore a mere contractual undertaking or negative covenant given by TAS to the appellant and in case of any breach of the covenant, the appellant's recourse is only against TAS for breach of its undertaking. The restrictive effect of that clause could not be extended to other creditors who were not parties to the said trust deed, unless of course it could be shown by evidence to have been assumed or agreed to by them (see paras 34–35).

[Bahasa Malaysia summary

Perayu merayu terhadap keputusan Mahkamah Tinggi berhubung isu awalan berkaitan keutamaan perayu sebagai pemiutang kepada responden kedua ('TAS') di mana hakim bijaksana menjawab isu awalan secara negatif bahawa perayu tidak mempunyai hak keutamaan lebih daripada pemiutang tidak bercagar dan bahawa hutang perayu mestilah dianggap *pari passu* dengan pemiutang skim tidak bercagar yang lain. Dalam kes ini, perayu merupakan pemegang amanah bagi pihak pemegang nota terma perantara ('NTP') yang dikeluarkan oleh TAS dalam tahun 2003. Sebagai pemegang amanah, perayu pada setiap masa merupakan pemiutang tidak bercagar TAS. NTP tersebut terbentuk oleh surat cara amanah yang dilaksanakan antara TAS dan perayu. Melalui fasal 10.1(cc) surat cara amanah, TAS berjanji dengan perayu bahawa TAS akan 'ensure that all or any advances by any of the shareholders, its directors and/or related corporations or any permitted intercompany loan and

advances made after the date of the trust deed are subordinated to TAS's liabilities under the CP/MTN Programme'. Responden-responden ketiga hingga ke-14 merupakan pegawai bank, di mana melalui satu perjanjian kemudahan, telah memberikan pinjaman tempoh bersindiket tidak bercagar kepada Transmile Air (SPV) Ltd, anak syarikat milik penuh responden pertama ('TGB'). Melalui penyerahan hak bertarikh 7 September 2010, Transmile Air telah menyerah hak hutang yang perlu dibayar oleh TAS kepada setiap individu pegawai bank tersebut ('responden-responden ketiga hingga ke-14'). Manakala responden ke-15 adalah anak syarikat milik penuh TGB ('responden pertama'). Responden ke-15 telah mengeluarkan bon-bon yang boleh diubah dalam tahun 2005. Bon-bon tersebut terbentuk oleh surat cara amanah bertarikh 17 Mei 2005. TGB menjamin bon-bon boleh diubar tersebut. Tindakan utama dalam prosiding ini telah dimulakan oleh TGB an TAS di bawah s 176 Akta Syarikat 1965 berhubung cadngan kesan skim urusan antara TGB dan TAS dan sekumpulan pemiutang ('pemiutang skim TAS'). Pemiutang skim TAS terdiri daripada tiga kumpulan pemiutang; adalah dicadangkan oleh TGB dan TAS bahawa ketiga-tiga kumpulan pemiutang tersebut, semua dianggap sebagai ahli satu kelas pemiutang tidak bercagar bagi tujuan mengundi atas perintah mahkamah-mesyuarat pemiutang skim yang patut diadakan sebelum skim yang dicadangkan itu dilaksanakan. Klasifikasi satu kelas pemiutang tidak bercagar tersebut bagaimanapun telah dibantah oleh perayu yang menegaskan bahawa hak mereka sebagai pemegang amanah kepada pemegang NTR, meskipun diakui sebagai pemiutang tidak bercagar TAS, adalah berbeza dan mempunyai lebih keutamaan daripada dua kumpulan lain pemiutang tidak bercagar tersebut, setakat mana aset-aset sedia ada adalah berkaitan. Pihak-pihak melalui satu perjanjian antara mereka, telah merumuskan isu awalan berikut: 'whether the amount owing by TAS to the appellant under the MTN has priority over the amount originally owing by TAS to Transmile Air (SPV) Ltd under the syndicated term loan, that has since been assigned by Transmile Air to the third to 14th respondents (in the present appeal); and the amount owing by TAS to the 15th respondent (in the present appeal) under the convertible bonds'. Hakim bijaksana menjawab isu awalan secara negatif iaitu hutang tidak bercagar yang timbul daripada pinjaman NTP kepada TAS tidak mempunyai keutamaan labih daripada hutang tidak bercagar pinjaman tempoh bersindiket dan bon boleh diubah tersebut; dan oleh itu hutang MTN hendaklah dianggap *pari passu* dengan pemiutang tidak bercagar yang lain. Hakim bijaksana juga memutuskan bahawa fasal 10.1(cc) dalam surat cara amanah NTP bukan fasal 'subordination' dan bahawa tiada kontrak nyata antara pemberi pinjaman inividu pinjaman tempoh bersindiket dan pemegang bon boleh diubah (atau mana-mana satu) dengan TAS atau TGB yang bersetuju untuk mengetepikan dan meletakkan hak-hak mereka sebagai pemiutang kepada tahap lebih rendah daripada pemiutang tidak bercagar lain TAS.

Diputuskan, menolak rayuan dengan kos:

(1) Pinjaman tempoh bersindiket dan pemegang bon boleh diubah, sama

ada secara langsung atau melalui jentera bertujuan khasnya (Transmile Air Ltd and TGB (SPV) Ltd), tidak terikat secara kontraktual kepada tanggungjawab di bawah fasal 10.1(cc) surat cara amanah NTP. Tiada keterangan untuk menyokong hujah bahawa pinjaman dan perjanjian bon yang dibuat dalam tahun 2005 bagi manfaat TAS telah dimasuki berasaskan bahawa hutang yang timbul adalah 'subordinate' kepada bayaran balik hutang NTP oleh TAS. Kedua-dua jentera bertujuan khas tersebut bukan pihak-pihak kepada surat cara amanah, yang dimasuki pada 8 Ogos 2003 antara TAS dan perayu. Fasal 10.1(cc) dalam surat cara amanah NTP berkuat kuasa pada tahun 2003 manakala jentera bertujuan khas yang ditubuhkan pada tahun 2005, tidak wujud pada masa tersebut dan oleh itu tidak berfungsi (lihat perenggan 19).

(2) Rukun *pari passu* di Malaysia adalah rukun statutori. Ia memberikan hak nyata kepada pemiutang apabila syarikat dalam pembubaran. Ia tidak boleh dikecualikan, kecuali dipersetujui secara jelas oleh pemiutang sendiri. Perjanjiannya untuk mengetepikan hak tersebut hanya mengikat dirinya. Pemiutang dan penghutang tidak bersetuju untuk mengetepikan hutang pemiutang lain yang bukan pihak kepada perjanjian. Kedudukan betul dari segi undang-undang adalah bahawa rukun *pari passu* adalah terpakai kepada hutang TAS dan semua pemiutang tidak bercagarnya, kecuali pemberi pinjaman kepada pinjaman tempoh bersindiket dan pemegang bon boleh diubah secara khusus bersetuju melepaskan hak mereka untuk menganggap ia *pari passu* atau diestopkan daripada menuntut taraf *pari passu* tersebut. Hutang tidak bercagar yang timbul daripada pinjaman NTP kepada TAS tidak mempunyai kelebihan hak atau keutamaan daripada hutang tidak bercagar lain kepada pinjaman tempoh bersindiket itu dan juga bon-bon boleh diubah itu (lihat perenggan 27).

(3) Rukun keutamaan saksama tidak terpakai kepada peruntukan statutori nyata s 292(2) Akta Syarikat 1965 ('Akta'). Bagi membenarkan rukun keutamaan saksama dalam kes ini jelas akan bertentangan dengan niat peruntukan nyata di bawah s 292(2) Akta tersebut (lihat perenggan 32).

(4) Tiada perjanjian wujud antara penghutang (TAS) dan pemiutang (berkaitan pinjaman tempoh bersindiket dan juga bon-bon boleh diubah tersebut), berhubung penepian hutang yang dikatakan itu. Perjanjian kemudahan bertarikh 16 Mei 2005 (dalam kes pinjamn tempoh bersindiket) dan surat cara amanah bertarikh 17 Mei 2005 (dalam kes bon-bon boleh diubah) tidak memperuntukkan peruntukan nyata sedemikian. Juga jelas bahawa fasal 10.1(cc) hanya menyatakan tanggungjawab TAS bagi memastikan pinjaman atau pendahuluan antara syarikat diketepikan daripada liabiliti TAS di bawah program NTP. Fasal 10.1(cc) dengan itu hanya akujanji kontraktual atau perjanjian negatif yang diberikan oleh TAS kepada perayu dan dalam kes

apa-apa pelanggaran tersebut, jalan keluar perayu hanya terhadap TAS untuk pelanggaran akujanjinya. Kesan terhad fasal tersebut tidak dilanjutkan kepada pemiutang lain yang bukan pihak kepada surat cara amanah tersebut, kecuali dapat dibuktikan oleh keterangan ia telah dianggap atau dipersetujui oleh mereka (lihat perenggan 34–35).]

Cases referred to

Attorney-General v McMilan & Lockwood Ltd [1991] 1 NZLR 53, CA (refd)
Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd and another [2011] UKSC 38, SC (refd)
British Eagle International Airlines Ltd v Compagnie National Air France [1975] 2 All ER 390, HL (refd)
Horne v Chester & Fein Property Developments Pty Ltd & Ors (1987) 5 ACLC 245, SC (refd)
Maxwell Communications Corpn plc (No 2), Re [1994] 1 All ER 737, Ch D (refd)
SSSL Realisations (2002) Ltd (in liquidation) and another company, RE [2005] 1 BCLC 1, Ch D (refd)
Stotter v Ararimu Holdings Ltd [1994] 2 NZLR 655, CA (refd)
United States Trust Co of New York v Australia & New Zealand Banking Group Ltd (1993) 11 ACSR 7 (refd)
United States Trust Co of New York v Australia & New Zealand Banking Group Ltd (1995) 17 ACSR 697, CA (refd)

Legislation referred to

Companies Act 1965 ss 176, 176(10), 292(1), (2)

Appeal from: Originating Summons No D-24NCC-239 of 2010 (High Court, Kuala Lumpur)

Lim Kian Leong (Lee May Lin, Paul Ngooi with him) (Lim Kian Leong & Co) for the appellant.
S Suhendran (SY Soh with him) (Kadir Andri & Partners) for the first and second respondents.
Rabindran Nathan (Allister Tan with him) (Shearn Delamore & Co) for the third to 14th respondents.
Azhar Azizan Harun (Cheang & Ariff) for the 15th respondent.

Ramly Ali JCA (delivering judgment of the court):

INTRODUCTION

[1] This is an appeal against the decision of the High Court on 22 December 2010 regarding a preliminary issue on the priority of the appellant as creditor of the second respondent ('TAS') where the learned judge answered the

preliminary issue in the negative to the effect that the appellant did not have any better right of priority to other unsecured creditors and that the appellant's debts must rank pari passu with the other unsecured scheme creditors.

FACTUAL BACKGROUND — BASED ON AGREED FACTS

[2] The second respondent (TAS) was a wholly owned subsidiary of the first respondent ('TGB'). TGB was in the business of air cargo transportation services, including chartering space on aircrafts owned and maintained by TAS. TAS was insolvent.

[3] In carrying out its operation, TAS entered into various funding arrangements to finance its operations involving various creditors. All the creditors were unsecured creditors.

[4] The appellant ('MTB') was the trustee for the holders of medium terms notes ('MTN') issued by TAS in 2003. As a trustee, the appellant at all material times was an unsecured creditor of TAS. The individual notes holders were not creditors of TAS.

[5] The medium terms notes (MTN) were constituted by a trust deed dated 8 August 2003 executed between TAS and the appellant. By cl 10.1(cc) of the trust deed, TAS covenanted with the appellant (MTB) that TAS would 'ensure that all or any advances by any of the shareholders, its directors and/or related corporations or any permitted inter-company loan and advances made after the date of the Trust Deed are subordinated to TAS's liabilities under the CP/MTN Programme'. The amount outstanding at the material time was RM105m.

[6] The third to 14th respondents are bankers, that by a facility agreement dated 16 May 2003, granted an unsecured syndicated term loan of USD100m to Transmile Air (SPV) Ltd, a company incorporated in Labuan and a wholly owned subsidiary of the first respondent (TGB). TGB guaranteed the said term loan. Transmile Air on-lent the term loan monies to TAS in 2005. The on-lent loan was also unsecured. By an assignment dated 7 September 2010, Transmile Air assigned the debt owing by TAS to the individual bankers (the third to 14th respondents). As at 30 April 2010, the principal outstanding was USD66.9m.

[7] The 15th respondent was a company incorporated in Labuan and was a wholly-owned subsidiary of TGB (the first respondent). The 15th respondent issued convertible bonds in 2005. The bonds were constituted by a trust deed dated 17 May 2005. TGB guaranteed the convertible bonds.

[8] The 15th respondent then on-lent the bond proceeds to TAS in 2005,

which were then used to acquire the 4 MD–11 aircraft and spares currently owned by TAS and had accordingly been used to increase the total assets of TAS. This loan was also unsecured. As at 30 April 2010 the total amount due from the 15th respondent to the convertible bonds holders was USD65.5m.

[9] The debts in question which were to be the subject matter of the proposed scheme of arrangement were the defaulted debts of TAS, which had all been guaranteed by TGB.

[10] The substantive action in this proceeding was brought by TGB and TAS under s 176 of the Companies Act 1965 with respect to a proposal to effect a scheme of arrangement between TGB and TAS and a group of creditors ('TAS scheme creditors'). The TAS scheme creditors comprised three groups of creditors; it was proposed by TGB and TAS that these three groups of creditors, be all treated as members of a single class of unsecured creditors for the purpose of voting at the requisite court-convened scheme-creditors meeting to be held in due course before the proposed scheme was implemented. This classification of a single class of unsecured creditors was however opposed by the appellant (MTB) who maintained that their rights as the trustee to the medium terms notes holders, although admittedly as an unsecured creditor of TAS, was nevertheless distinct and ranked in priority to the other two groups of unsecured creditors, in so far as satisfaction from available assets were concerned.

[11] The parties by consent required the court to make a preliminary finding and by agreement amongst themselves, formulated the following preliminary issue for determination:

> whether the amount owing by TAS to MTB under the medium term notes has priority over the amount originaily owing by TAS to Transmile Air (SPV) Limited under the syndicated term loan, that has since been assigned by Transmile Air to the Respondents 3 to 14 (in the present appeal); and the amount owing by TAS to Respondent 15 (in the present appeal) under the convertible bonds.

[12] The appellant contended that they had a better right or priority over the other scheme creditors. It was basically hinged upon what was claimed to be a subordination clause as found in cl 10.1(cc) of the trust deed dated 8 August 2003 where TAS had covenanted with the appellant (as trustees for the MTN holders) to the effect that TAS would ensure that all or any advances by any of the subsidiaries, its directors and/or related corporations or any permitted intercompany loan or advances made after the date of the trust deed were subordinated to TAS liabilities under CP/MTN programmes.

[13] The appellant argued that the lenders for the syndicated term loan and

the holders of the convertible bonds through the 15th respondent ('TGB (SPV) Ltd'), had knowledge of the subordination clause (cl 10.1(cc)) and were bound to it by implication and were otherwise estopped from denying the effect of that clause; and therefore they could not claim that the debts on their loans to TAS ranked pari passu with the debts due to the medium term notes (MTN) holders.

[14] The appellant argued that the syndicated term loans by the third to 14th respondents made to TAS through Transmile Air (SPV) Ltd and the convertible bonds issued by TGB (SPV) Ltd (the 15th respondent) were advances made by 'the subsidiaries' or 'inter-company loans' that fell squarely within the ambit of cl 10.1(cc) of the trust deed and all such debts arising even subsequently were therefore 'subordinated' to the debts owed to the appellant by TAS. The appellant contended the MTN debt did not rank pari passu with the syndicated term loan debt and the convertible bonds debt.

[15] The respondents on the other hand took the position that Transmile Air (SPV) Ltd and TGB (SPV) Ltd (the 15th respondent) were 'mere conduits' only in the transactions used for the purpose of 'on-lending' the respective loans to TAS. The loan amounts denominated in USD and had been obtained from external sources; therefore the respondent maintained that the sums advanced to TAS did not in any event come from the own fund of Transmile Air Ltd or TGB (SPV) Ltd for that matter. The true lenders of the amounts that formed the loans advanced to TAS were the individual lenders of the syndicated term loan and the convertible bonds holders; and therefore the loans were not 'inter-company loan' as alleged by the appellant.

[16] The respondents further submitted that both Transmile Air Ltd and TGB (SPV) Ltd were special purpose vehicles, incorporated subsequently in 2005, were not in any event parties to the MTN trust deed of 2003 and cl 10.1(cc) of the said trust deed did not bind both of them. There was no express agreement by the syndicated term loan lenders and the convertible bond holders at anytime to 'subordinate' or waive their rights in favour of the MTN holders as claimed by the appellant.

DECISION OF THE HIGH COURT

[17] The learned judge answered the preliminary issue in the negative ie the unsecured debt arising from the MTN loan to TAS did not have any better right of priority to the other unsecured debts of the syndicated term loan and the convertible bond; and therefore the MTN debt must rank pari passu with the other scheme creditors.

[18] The learned judge also held that:

(a) cl 10.1(cc) in the MTN trust deed was not a 'subordination' clause;

(b) that clause was merely a negative covenant on the part of TAS and for any breach of the same, the MTN holders recourses were limited only against TAS;

(c) there was no express contract between individual lenders of the syndicated term loan and the convertible bond holders (or any of them) with either TAS or even TGB whereby the individual lenders of the syndicated term loan and the convertible bond holders had agreed to relegate their rights as creditors to rank lower than the other unsecured creditors of TAS; and

(d) the burden was on the appellant to establish on evidence that Transmile Air Ltd, the syndicated term loan lenders and the convertible bond holders were stopped from denying that TAS's debt to the latter would rank lower in priority to the MTN debt for the purpose of settlement and this had not been done.

FINDINGS OF THIS COURT

Effect of MTN trust deed on the syndicated term loan lenders and the convertible bond holders

[19] The evidence in this case indicated that the syndicated term loan lenders and the convertible bond holders, either directly or through their respective special purpose vehicles (Transmile Air Ltd and TGB (SPV) Ltd), were not contractually bound to the obligations under cl 10.1(cc) of the MTN trust deed. There was no evidence to support the contention that the loan and bond agreements made in 2005 for the benefit of TAS were entered on the footing that the debts arising thereby were 'subordinate' to repayment by TAS of the MTN debts. The two special purpose vehicles were not parties to the MTN trust deed, which was entered into on 8 August 2003 between TAS and the appellant (MTB). Clause 10.1(cc) in the MTD 'Trust Deed' came into force in 2003 while the said special purpose vehicles which were incorporated in 2005, were not even in existence at that time and therefore could not operate on them.

[20] We are in full agreement with the learned judge on this point when His Lordship at p 22, para 13.1 of the grounds of judgment states:

> STL-SPV and CB-SPV were not parties to the MTN trust deed (2003) and neither were they required to consent to any 'subordination' arrangement in favour of the MTN lenders when the facilities through the STL-SPV and the CB-SPV were extended to TAS in 2005. This has been discussed above. Contractually therefore,

A the STP-SPV or for the matter the CB-SPV were not bound at all to the legal effects of cl 10.1(cc). From the perspective of time, it should be highlighted that STP-SPV and CB-SPV were only incorporated in 2005, that is, subsequent to the MTN trust deed entered into in 2003 wherein cl 10.1(cc) was found.

B

The pari passu rule

C **[21]** It is not in dispute that at the material time, TAS was insolvent. A winding up petition vide Kuala Lumpur (Companies Winding up) No 28-NCC-378 of 2010 had been presented by the appellant (MTB) to liquidate TAS on the grounds of TAS's insolvency. Further action on the winding up petition however had been stayed as a consequence of the restraining orders under s 176(10) of the Companies Act 1965 made in these proceedings on 14 D July 2010. Accordingly, the determination of the preliminary issues posed here have also to be in the context of the winding up petition now pending in court against TAS.

E **[22]** The pari passu rule is the cornerstone of insolvency law. It is one of the most fundamental principles of the law of liquidation and is at the very heart of the whole statutory scheme of winding up. It is considered as the most universal of all insolvency principles. It is an old equitable principle that all persons similarly situated are entitled to equality in treatment in the F distribution of the assets of the company in the process of liquidation (see *McPherson's Law of Company Liquidation* at para 13.100, at pp 13–1051 and *Roy Goode Principles of Corporate Insolvency Law* at p 175 para 7.02).

[23] Section 292(1) of the Companies Act 1965 deals with matters relating G to distribution of assets in the winding up of an insolvent company ie the liquidator is obliged to apply the unencumbered assets of the company first to settle the statutory preferential debts under the provisions of the section and secondly under sub-s (2) to pay the unsecured debts of the company pari passu ie 'debts of the same class shall rank equally between themselves, and shall be H paid in full, unless the property of the company is insufficient to meet them, in which case they shall abate in equal proportions between themselves'.

[24] The pari passu rule is considered as mandatory in its application on the grounds of public policy. It reflects the principle that statutory provisions for I pro rata distribution may not be excluded by a contract which gives one creditor more than its proper share (see *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd and another* [2011] UKSC 38 — Supreme Court UK and *British Eagle International Airlines Ltd v Compagnie National Air France* [1975] 2 All ER 390).

[25] The rule has been relaxed; now a creditor may voluntarily agree to subordinate its debt. A different distribution can be obtained by subordination agreements between the creditors (see *Belmont Park Investments*). So, now the pari passu rule may be avoided through a subordination agreement between the all creditors. The rule is that no one creditor can contract with the debtor to put himself in a better position than other creditors; this is because such arrangements provide a preference over creditors who never agreed to give up their rights. No one creditor or group of creditors can lawfully contract in such a manner as to defeat other creditors not parties to the contract (see *Horne v Chester & Fein Property Developments Pty Ltd* (1987) 5 ACLC 245; *Stotter v Ararimu Holdings Ltd* [1994] 2 NZLR 655, and *Attorney-General v Mc Milan & Lockwood Ltd* [1991] 1 NZLR 53).

[26] In short the position now is that a creditor may voluntarily subordinate its debt by agreement or by waiver. However, a creditor and the debtor cannot agree to subordinate the debts of another creditor not a party to the agreement or without its consent. A creditor is entitled to waive its debt, if it chooses to, just as it is entitled to decline to submit a proof of debt in the process of liquidation (see *Re Maxwell Communications Corpn plc (No 2)* [1994] 1 All ER 737; *Re SSSL Realisations (2002) Ltd (in liquidation) and another company* [2005] 1 BCLC 1; and *United States Trust Co of New York v Australia & New Zealand Banking Group Ltd* (1993) 11 ACSR 7; (1995) 17 ACSR 697). There must be evidence to show that the creditor personally agrees to such a choice. An agreement of another creditor to that effect will not bind it. The proposition that a creditor is bound by a subordination clause merely because it had knowledge of the clause is wholly incorrect. The only way a creditor may be subordinated is if it agrees to the subordination or is estopped from claiming a pari passu ranking.

[27] In the present case, TAS was insolvent and under liquidation. This is not in dispute. In Malaysia besides the relevant authorities cited above, pari passu rule is expressly stated under s 292(2) of the Companies Act 1965 ie other than the preference payment of debts listed under s 292(1) of the same Act, other unsecured debts of the same class 'shall rank equally between them' and if the property of the company is insufficient to meet them, they 'shall abate in equal proportions between themselves'. In short, the pari passu rule in Malaysia is a statutory rule. It confers express right to the creditors when the company is under liquidation. It cannot be excluded, unless expressly agreed by the creditor itself. Its agreement to subordinate or to waive the right only binds itself. A creditor and the debtor cannot agree to subordinate the debts of another creditor not a party to the agreement (see *Re Maxwell Communication Corpn*). Therefore, in the present case, the correct position of law is that the pari passu rule will apply to TAS debts and all its unsecured creditors, unless the

lenders to the syndicated term loan and the convertible bond holders specifically contracted away their right to rank pari passu or are estopped from claiming a pari passu ranking.

[28] Therefore, on this issue, we are in full agreement with the learned judge that the unsecured debts arising from the MTN loan to TAS did not have any better right or priority to the other unsecured debt of the syndicated term loan as well as the convertible bonds. In short, all those unsecured debts are to rank pari passu or equally between themselves, and distribution of TAS's property among them must be in line with the rule under s 292(2) of the Companies Act 1965 ie in full or in equal proportions between themselves.

[29] On this ground alone, the answer to the preliminary issue ie whether the amount owing by TAS to MTB has priority over the syndicated term loan and the convertible bonds, must be in the negative, and on this ground alone, the appeal herein must fail and can be dismissed.

[30] As stated earlier, cl 10.1(cc) of the MTN trust deed does not bind the syndicated term loan lenders as well as the convertible bond holders. Therefore the issue of 'inter-company loan' as canvassed strongly by the appellant and all other provisions stipulated in the said clause are not applicable and should not arise at all in the determination of the preliminary issue referred to the court.

[31] The appellant raised the issue of equitable priority in this case saying that equitable priority rule applies in favour of the appellant. With respect, we are not in a position to agree with the appellant on this issue. We note that the dispute herein concerned competing unsecured claims against the assets of an insolvent company TAS. The issue here is one of subordinating one unsecured claim by virtue of a pure contractual provision; there is no computing 'equities' at all. They are not governed by the traditional equitable priority rule, where priority is determined by order of time of creation of the debts (see WJ Gough, *Company Charges* (2nd Ed), at p 374). In any event, as stated earlier, the application of the pari passu rule in Malaysia is a statutory requirement under s 292(2) of the Companies Act 1965. This by itself negate the application of the equitable priority rule as advocated by the appellant in this case.

[32] Equitable priority rule cannot be applied at the expense of an express statutory provision of s 292(2) of the Companies Act 1965. To allow equitable priority rule in the present case will obviously be contrary to the spirit of the express provisions under s 292(2) of the Act.

[33] In any event, the court is of the view that, cl 10.1(cc) of the MTN trust deed was not a subordination clause as contended by the appellant. We agree with the learned judge's finding that cl 10.1(cc) did not fall into any one of the

three basic categories of recognised subordination agreement as categorised by Lloyd J in *Re SSSL Realisations (2002) Ltd (in liquid ation) and another company* [2005] 1 BCLC, as follows:

(a) a 'True Subordinated Debt' where the terms on which the debt is incurred by an agreement between the debtor and the creditor provide for payment to the creditor to be subordinated to other payments to be made by the debtor;

(b) where there was a 'Priorities Agreement' between two or more creditors of the same debtor where they agree to alter the priority in which they would receive payment as between themselves; or

(c) where a 'Trust Arrangement' existed ie where one creditor agrees to hold proceeds received from a common debtor for the benefit of another creditor.

[34] As regards the first category, no agreement ever existed between the debtor (TAS) and the creditors (in respect of the syndicated term loan as well as the convertible bonds), with regard to the alleged subordination of debt. The facility agreement dated 16 May 2005 (in the case of the syndicated term loan) and the trust deed dated 17 May 2005 (in the case of the convertible bonds) provide no such express provisions. Applying the above yardstick, it is also obvious that cl 10.1(cc) did not fall into the second and third categories.

[35] It is also obvious that cl 10.1(cc) only spelt out TAS's obligation to ensure that intercompany loans or advances were subordinated to TAS's liabilities under the MTN programme. Clause 10.1(cc) was therefore a mere contractual undertaking or negative covenant given by TAS to the appellant and in case of any breach of the covenant the appellant's recourse is only against TAS for breach of its undertaking. The restrictive effect of that clause could not be extended to other creditors who are not parties to the said trust deed, unless of course it can be shown by evidence to have been assumed or agreed to by them.

[36] The appellant also submitted at length on the issue of estoppel in order to establish that the loan and bonds in question were 'inter-company loans' as stipulated under cl 10.1(cc) of the MTN trust deed. This court is of the view that once cl 10.1(cc) was not applicable, the issue relating to 'inter-company loans' as stipulated therein did not arise at all. Therefore, the appellant's submissions on estoppel are totally irrelevant and hold no water.

CONCLUSION

[37] On the above considerations, we agree with the learned judge's decision

A and affirm that the MTN loan creditors rank pari passu with the other creditors of the syndicated term loan and the convertible bond holders. The appeal before us is clearly without merit. We therefore dismiss the appeal with costs of RM10,000 to each set of the solicitors for the respondents and order that the deposit to be refunded.

B

Appeal dismissed with costs.

Reported by Ashgar Ali Ali Mohamed

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